

# Investment Market Review Second Quarter 2016

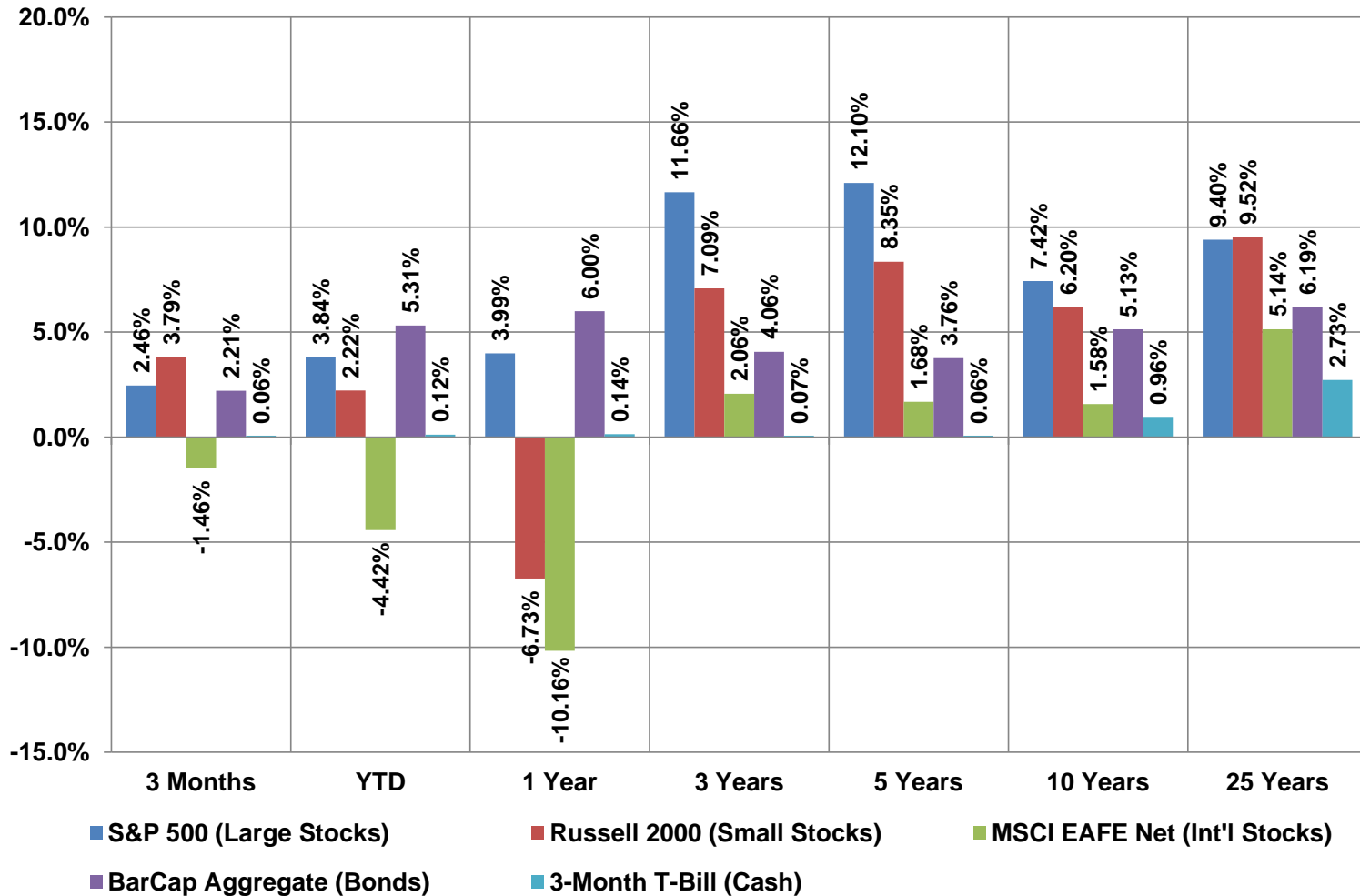
## State of Montana

# Capital Market Highlights

- U.S. stocks produced positive returns during the second quarter with the S&P 500 index returning +2.5%. Bonds also had a strong second quarter with the Barclay's Capital US Aggregate index up +2.2%.
- International developed market stocks returned -1.5% for the quarter adding to the -3.0% loss experienced during the first quarter. Returns on emerging markets stocks moved further into positive territory in the second quarter with the MSCI Emerging Markets index returning +0.7% and is up +6.4% year-to-date. Emerging markets debt continued to post strong positive returns into the second quarter with the JP Morgan Emerging Markets Bond index returning +5.4% and is up +10.9% year-to-date.
- Earlier forecasts projected four rate hikes throughout 2016; however, mild economic data and tepid inflation now point to zero to one rate hike by the end of the year. A similar scenario played out in 2015 with multiple projected rate increases never materializing. The vote by Great Britain to leave the European Union in late June pulled markets sharply lower before a modest rebound. The Federal Reserve has cited uncertainty surrounding this decision as a reason to proceed cautiously with future rate increases. Wage growth has improved to 2.6%, but still lags the Fed's target of 3.5%.
- The unemployment rate dropped to 4.7% in May before increasing slightly to end the quarter at 4.9%. A lower than expected 11,000 jobs were added in May followed by a rebound in June with 287,000 new jobs. The slight increase in the unemployment rate from May to June shows that more Americans may be entering the workforce as the economy improves and are now reflected in the unemployment rate.
- The labor force participation rate reached its lowest levels in nearly 40 years in September 2015, and has trended higher through the end of the first quarter. The LFPR reached 63% in March, dropped to 62.6% in May and rebounded to 62.7% at the end of the second quarter. This number should continue to increase as workers gain a higher level of optimism in the economic recovery as evident in personal consumption continuing to be a leading contributor to GDP.
- Inflation finally moved close to 1% in the fourth quarter after bouncing between -0.1% and +0.1% for the first three quarters of 2015. At the end of the first quarter inflation came in at 0.9% and continues to be a headwind for the pace of rate increases. The Fed is targeting 2%, but this level hasn't been reached since 2014.
- West Texas Intermediate (WTI) oil futures continue their volatility and generally within a range of \$40-\$50 per barrel over the second quarter and is up nearly 30% from the first quarter. After a drop in the first few days of April, the trend was generally up during the remainder of the second quarter. Supply and demand appear to be moving more into balance, but uncertainty surrounding Great Britain may add to volatility.

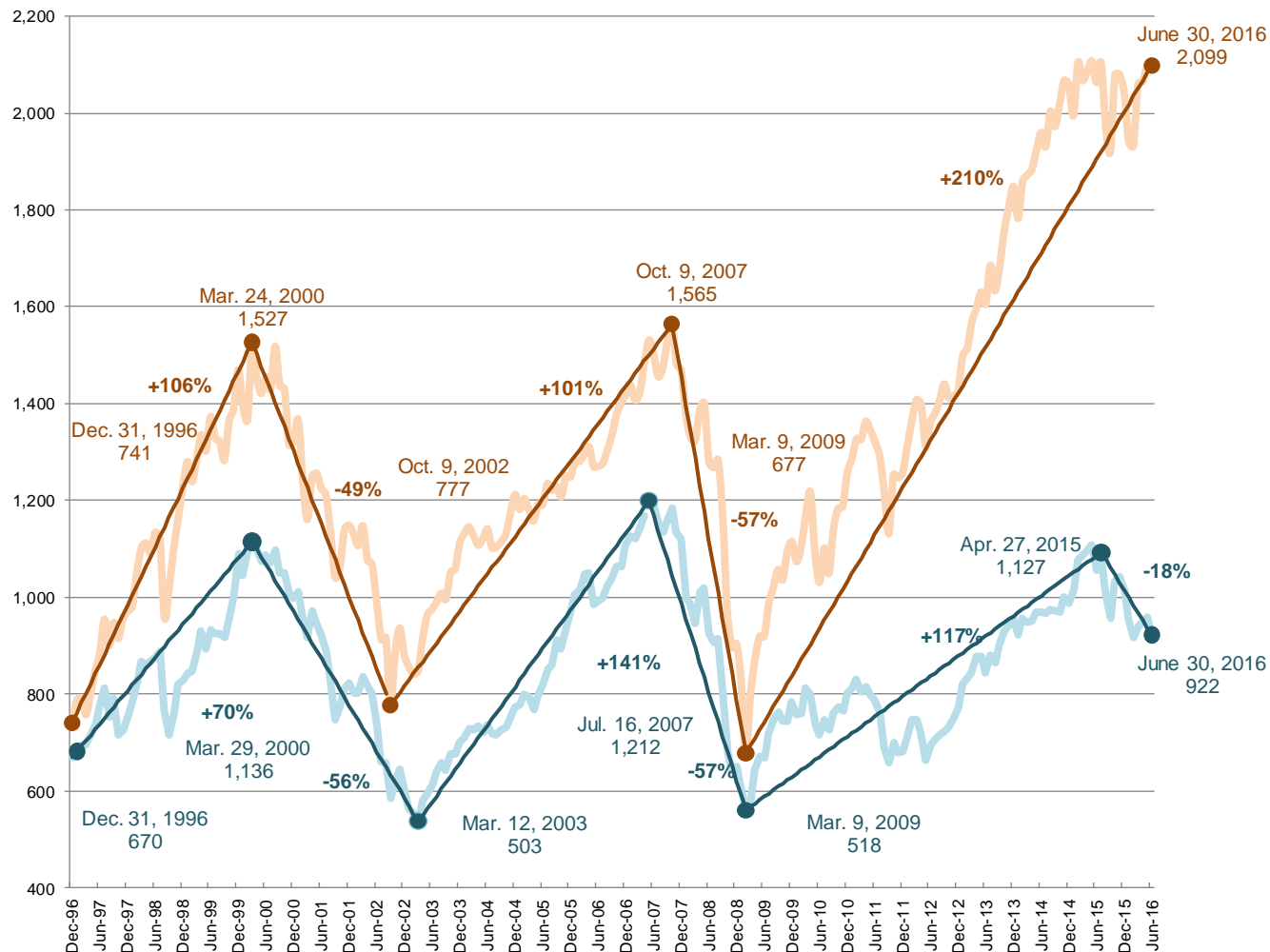
# Capital Market Highlights

Capital Market Performance as of June 30, 2016



# Capital Market Highlights

## S&P 500 and MSCI EAFE at Inflection Points



S&P 500	P/E (fwd)
Dec. 31, 1996	16.0
Mar. 24, 2000	25.6
Oct. 9, 2002	14.1
Oct. 9, 2007	15.2
Mar. 9, 2009	10.3
June 30, 2016	16.6

MSCI EAFE	P/E (fwd)
Dec. 31, 1996	19.5
Mar. 29, 2000	28.7
Mar. 12, 2003	13.2
Jul. 16, 2007	14.5
Mar. 9, 2009	10.2
Apr. 27, 2015	18.1
June 30, 2016	14.1

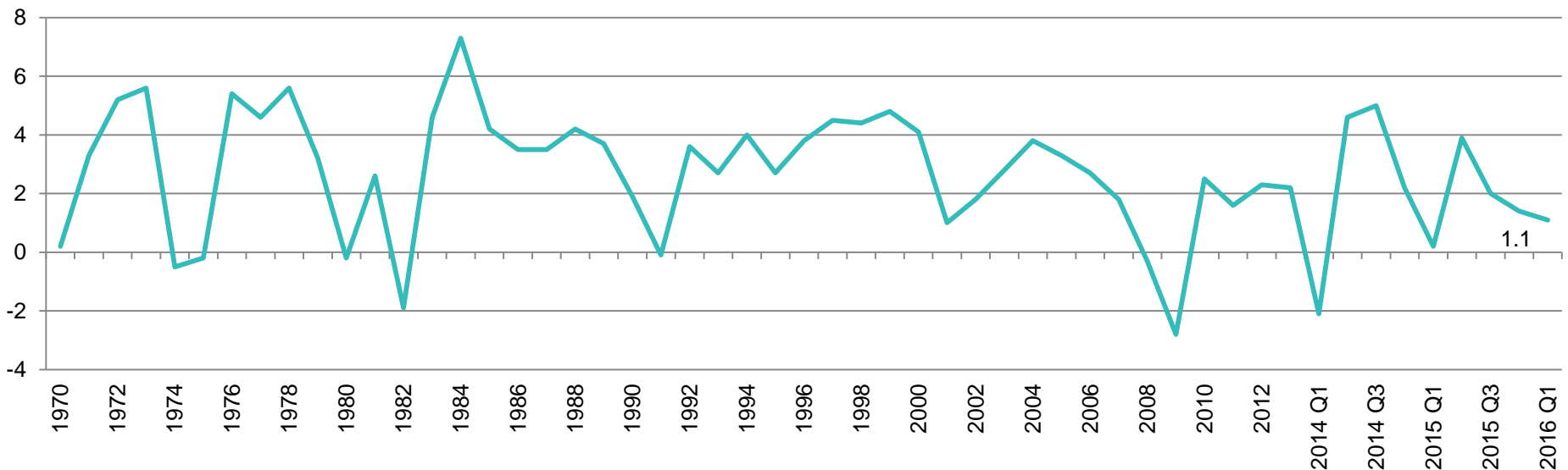
Source: Standard & Poor's,  
Morgan Stanley Capital International,  
J.P. Morgan Asset Management

Returns based on S&P 500 Index Price Movement and  
MSCI EAFE Local Currency Index Price Movement

# US Economy

- GDP growth has been slowing over the last year. Annualized GDP in the second quarter of 2016 was 1.1%, which is down from 3.9% in the second quarter of 2015. Personal consumption expenditures continue to be among the leading contributors to GDP with residential fixed investment and state and local government spending also being among the largest contributors to first quarter GDP. Federal government spending, private inventory investment, and nonresidential fixed investment were detractors during the quarter.
- GDP estimates for the second half of 2016 are between 2% to 2.5%, which would put 2016 GDP on the low end of this range. Second quarter GDP numbers have not been released.

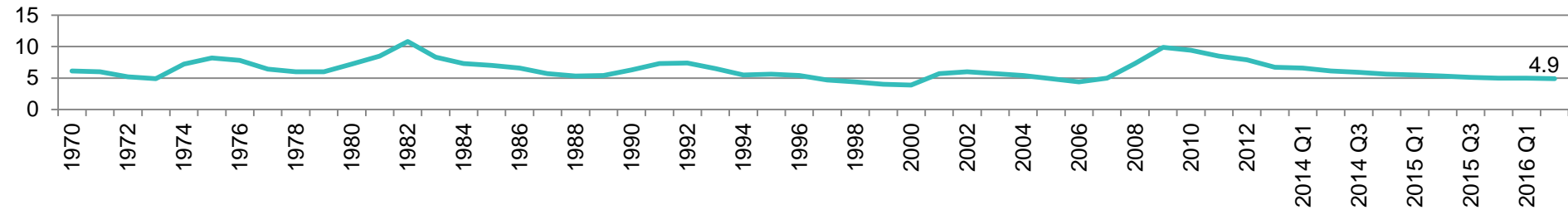
**Real GDP**



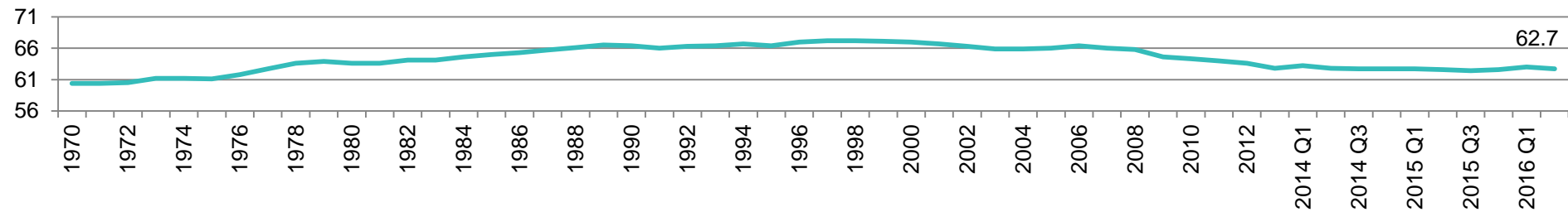
Source: BEA

# US Economy

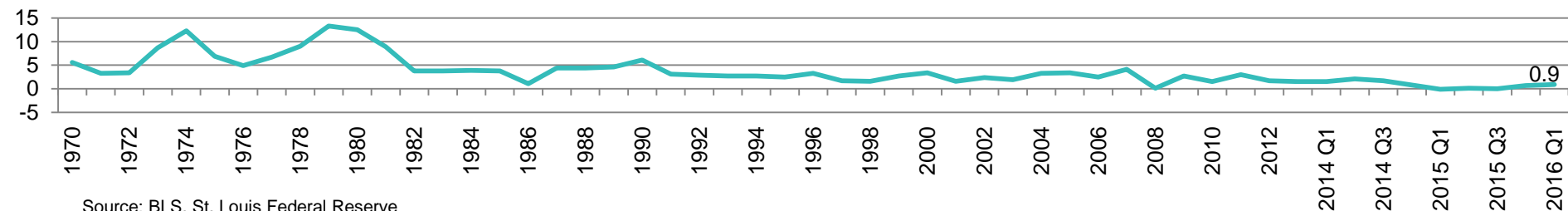
## Unemployment



## Labor Force Participation Rate



## Headline CPI

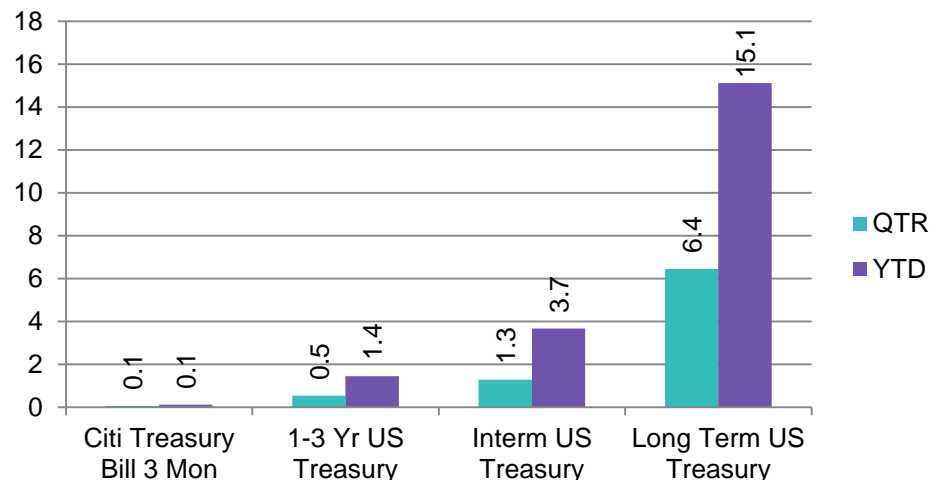


Source: BLS, St. Louis Federal Reserve

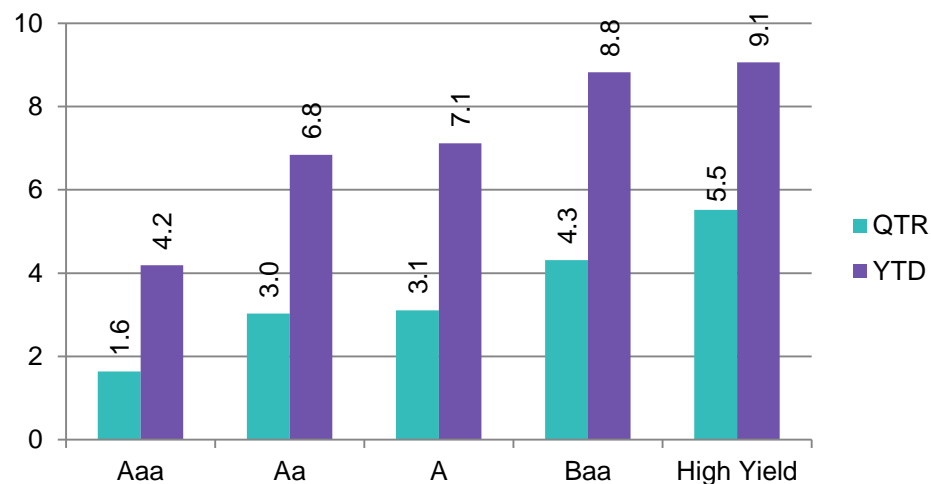
# Fixed Income

- **High Yield** struggled in 2015 and was about even with investment grade fixed income through the first quarter. High yield outperformed in April and May before giving up some ground In June to finish about 200bps ahead for the second quarter. High yield produced a positive return of +5.5%, outperforming the investment grade fixed income return of +3.6%.
- The yield on 10 Year Treasury Notes was essentially flat over the second quarter through June 23. It began the quarter at 1.79% and stood at 1.74% on June 23. On June 30, the yield was 1.49%; a level last seen in 2012.

## Bond Performance by Maturity



## Bond Performance by Quality

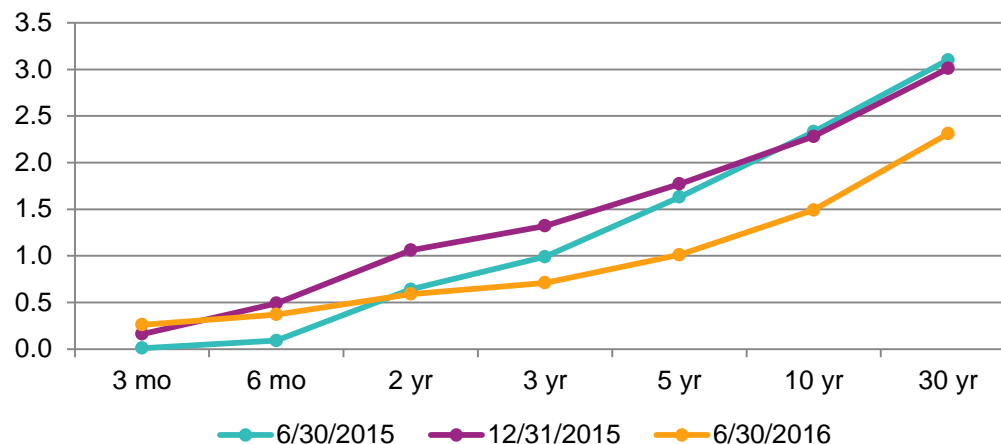


Source: Morningstar, Barclays Capital US Credit Indices

# Fixed Income

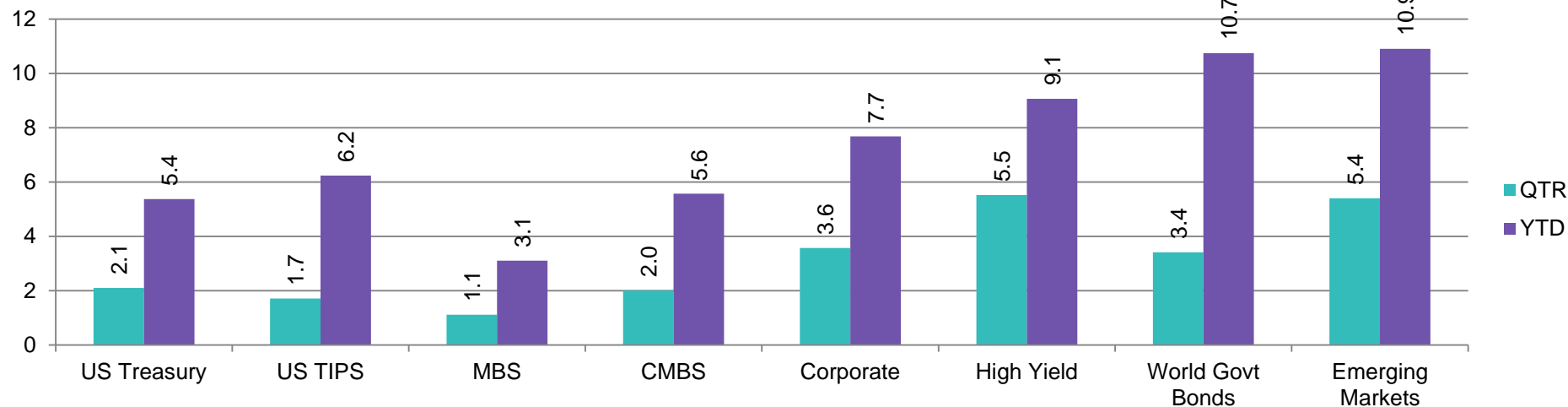
- The **Barclays Aggregate Index** returned +2.2% for the quarter.
- **Long Gov/Credit** and **Long Treasuries** returned +6.6% and +6.4% for the quarter, respectively. Long Gov/Credit is up +14.3% YTD and Long Treasuries are up 15.1% YTD.

## US Treasury Yield Curve



Source: Barclays

## Bond Performance by Sectors

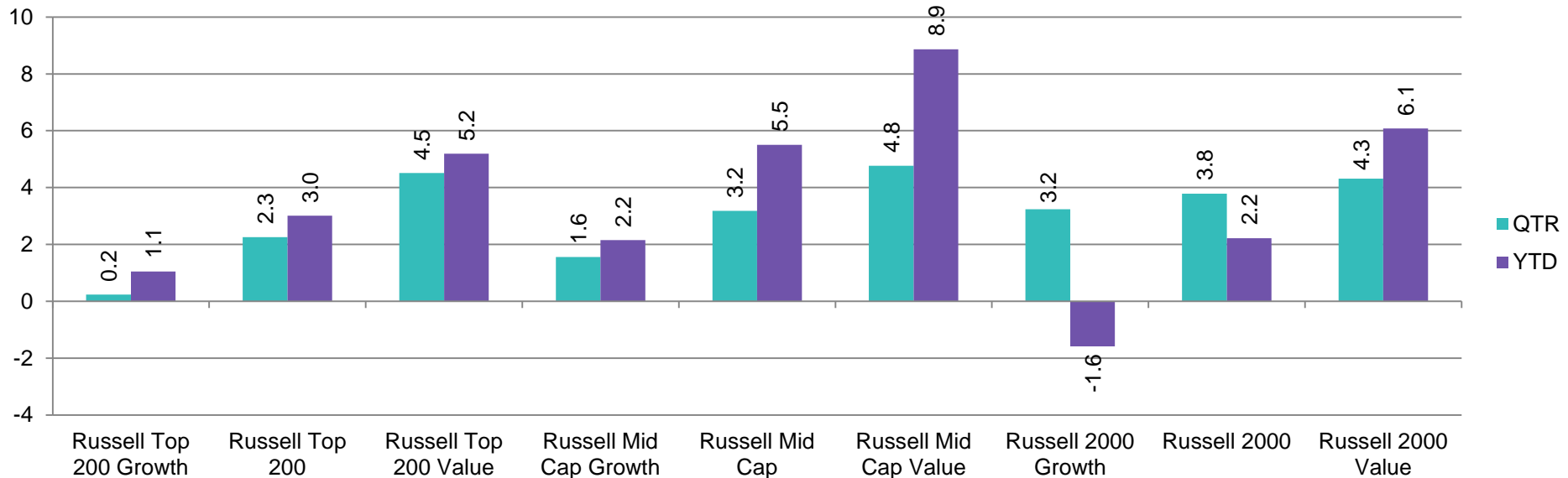


Source: Morningstar

# Equities

- US Equities were up for the quarter, with the **S&P 500** returning +2.5 %.
- In terms of market capitalization, small cap stocks (**Russell 2000**) performed the best, returning +3.8% for the quarter. In comparison, large- and mid-cap returned +2.3% and +3.2%, respectively, as measured by the **Russell Top 200** and the **Russell Mid Cap**. Value stocks in all market caps outperformed growth stocks during the quarter, but lag over longer periods.
- Performance accelerated in the second quarter after a slightly positive first quarter and month-to-month volatility was lower than in the previous quarter. The Dow delivered a return of +2.6% during the second quarter, with most of the returns coming in May.

US Stocks by Capitalization/Style

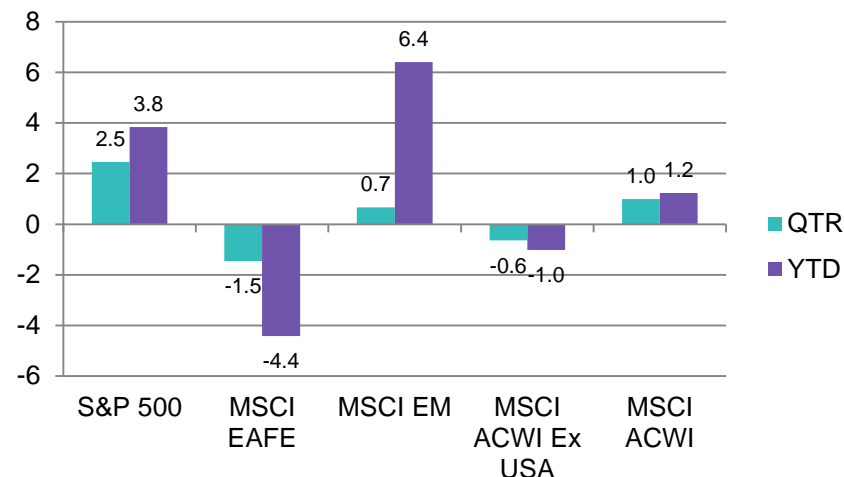


Source: Morningstar

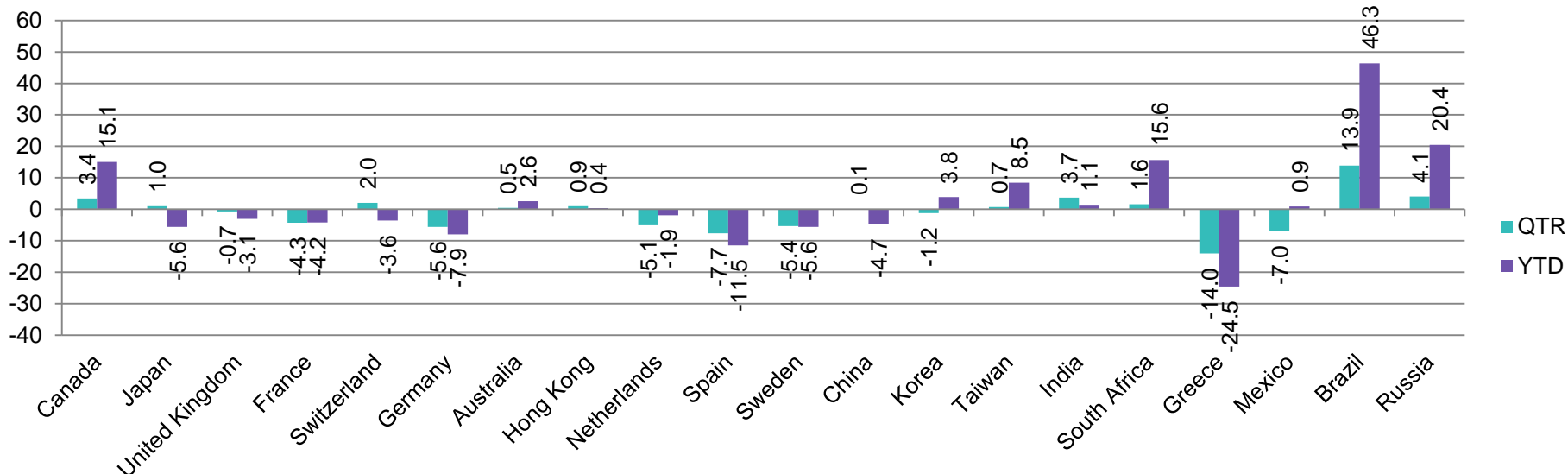
# Equities

- **International Equities** were negative over the quarter with developed market equities returning -1.5%. German equities lost -5.6%, French equities lost -4.3%, and Switzerland was up +2.0%. The United Kingdom was down just -0.7%. After a difficult first quarter, Japan was able to produce a positive +1.0% return for the second quarter.
- **Emerging Market Equities** were slightly positive with a return of +0.7% in the second quarter. China returned +0.1%, South Korea was down -1.2%, Taiwan was up 0.7%, and India was up 3.7%.

## Global Stocks by Region



## Global Stocks by Country



Source: Morningstar

# Market Indices

## For Periods Ended June 30, 2016

Index	3 Months Return	6 Months Return	9 Months Return	1 Year Return	2 Years Return	3 Years Return	4 Years Return	5 Years Return	10 Years Return
S&P 500 Index	2.46	3.84	11.15	3.99	5.69	11.66	13.83	12.10	7.42
Russell 1000 Index	2.54	3.74	10.48	2.93	5.13	11.48	13.84	11.88	7.51
Russell Midcap Index	3.18	5.50	9.31	0.56	3.55	10.80	14.28	10.90	8.07
Russell 2000 Index	3.79	2.22	5.89	-6.73	-0.34	7.09	11.13	8.35	6.20
Russell 3000 Index	2.63	3.62	10.12	2.14	4.68	11.13	13.62	11.60	7.40
Russell 1000 Growth Index	0.61	1.36	8.78	3.02	6.72	13.07	14.06	12.35	8.78
Russell 1000 Value Index	4.58	6.30	12.29	2.86	3.49	9.87	13.54	11.35	6.13
Russell Midcap Growth Index	1.56	2.15	6.36	-2.14	3.49	10.52	13.49	9.98	8.12
Russell Midcap Value Index	4.77	8.87	12.27	3.25	3.46	11.00	14.94	11.70	7.79
Russell 2000 Growth Index	3.24	-1.59	2.66	-10.75	0.13	7.74	11.52	8.51	7.14
Russell 2000 Value Index	4.31	6.08	9.13	-2.58	-0.92	6.36	10.69	8.15	5.15
MSCI EAFE Index	-1.46	-4.42	0.08	-10.16	-7.24	2.06	5.97	1.68	1.58
MSCI Emerging Markets Index	0.66	6.41	7.11	-12.06	-8.66	-1.56	-0.47	-3.78	3.54
MSCI All Country World ex USA	-0.64	-1.02	2.19	-10.24	-7.78	1.16	4.15	0.10	1.87
NAREIT Equity REITs	6.96	13.38	21.61	24.04	13.76	13.58	12.52	12.60	7.45
Barclays Capital Aggregate Bond Index	2.21	5.31	4.71	6.00	3.91	4.06	2.85	3.76	5.13
Barclays Capital Intermediate G/C Bond Index	1.59	4.07	3.35	4.33	3.00	2.95	2.28	2.90	4.48
Barclays Capital Long Term G/C Bond Index	6.55	14.33	13.25	15.72	8.61	9.33	5.64	9.18	8.42
Barclays Capital U.S. TIPS	1.71	6.24	5.56	4.35	1.27	2.31	0.49	2.63	4.75
Barclays Capital U.S. Government	2.04	5.22	4.26	6.04	4.14	3.45	2.18	3.38	4.73
Barclays Capital U.S. Corporate Inv Grade	3.57	7.68	7.06	7.94	4.28	5.42	4.39	5.43	6.24
Barclays Capital U.S. Corporate High Yield	5.52	9.06	6.81	1.62	0.61	4.18	5.49	5.84	7.56
Citigroup Non-US WGBI USD	4.04	13.50	11.94	13.85	-0.76	2.36	0.28	0.31	3.97
JP Morgan EMBI Global Diversified USD	5.02	10.31	11.69	9.79	5.05	7.20	5.64	6.45	7.97
JP Morgan GBI EM Global Diversified USD	2.71	14.02	14.01	1.99	-7.11	-3.57	-2.37	-2.23	5.72
Citigroup 90-Day Treasury Bills	0.06	0.12	0.13	0.14	0.08	0.07	0.07	0.06	0.96

Note: Returns greater than one year are annualized.

# Market Indices

## Annual Returns

Index	2015	2014	2013	2012	2011	2010	2009	2008	2007	2006
S&P 500 Index	1.38	13.69	32.39	16.00	2.11	15.06	26.46	-37.00	5.49	15.79
Russell 1000 Index	0.92	13.24	33.11	16.42	1.50	16.10	28.43	-37.60	5.77	15.46
Russell Midcap Index	-2.44	13.22	34.76	17.28	-1.55	25.48	40.48	-41.46	5.60	15.26
Russell 2000 Index	-4.41	4.89	38.82	16.35	-4.18	26.85	27.17	-33.79	-1.57	18.37
Russell 3000 Index	0.48	12.56	33.55	16.42	1.03	16.93	28.34	-37.31	5.14	15.72
Russell 1000 Growth Index	5.67	13.05	33.48	15.26	2.64	16.71	37.21	-38.44	11.81	9.07
Russell 1000 Value Index	-3.83	13.45	32.53	17.51	0.39	15.51	19.69	-36.85	-0.17	22.25
Russell Midcap Growth Index	-0.20	11.90	35.74	15.81	-1.65	26.38	46.29	-44.32	11.43	10.66
Russell Midcap Value Index	-4.78	14.75	33.46	18.51	-1.38	24.75	34.21	-38.44	-1.42	20.22
Russell 2000 Growth Index	-1.38	5.60	43.30	14.59	-2.91	29.09	34.47	-38.54	7.05	13.35
Russell 2000 Value Index	-7.47	4.22	34.52	18.05	-5.50	24.50	20.58	-28.92	-9.78	23.48
MSCI EAFE Index	-0.81	-4.90	22.78	17.32	-12.14	7.75	31.78	-43.38	11.17	26.34
MSCI Emerging Markets Index	-14.92	-2.19	-2.60	18.22	-18.42	18.88	78.51	-53.33	39.42	32.14
MSCI All Country World ex USA	-5.66	-3.87	15.29	16.83	-13.71	11.15	41.45	-45.53	16.65	26.65
NAREIT Equity REITs	3.20	30.14	2.47	18.06	8.29	27.96	27.99	-37.73	-15.69	35.06
Barclays Capital Aggregate Bond Index	0.55	5.97	-2.02	4.21	7.84	6.54	5.93	5.24	6.97	4.33
Barclays Capital Intermediate G/C Bond Index	1.07	3.13	-0.86	3.89	5.80	5.89	5.24	5.08	7.39	4.08
Barclays Capital Long Term G/C Bond Index	-3.30	19.31	-8.83	8.78	22.49	10.16	1.92	8.44	6.60	2.71
Barclays Capital U.S. TIPS	-1.44	3.64	-8.61	6.98	13.56	6.31	11.41	-2.35	11.64	0.41
Barclays Capital U.S. Government	0.86	4.92	-2.60	2.02	9.02	5.52	-2.20	12.39	8.66	3.48
Barclays Capital U.S. Corporate Inv Grade	-0.68	7.46	-1.53	9.82	8.15	9.00	18.68	-4.94	4.56	4.30
Barclays Capital U.S. Corporate High Yield	-4.47	2.45	7.44	15.81	4.98	15.12	58.21	-26.16	1.87	11.85
Citigroup Non-US WGBI USD	-5.54	-2.68	-4.56	1.51	5.17	5.21	4.39	10.11	11.45	6.94
JP Morgan EMBI Global Diversified USD	1.18	7.43	-5.25	17.44	7.35	12.24	29.82	-12.03	6.16	9.86
JP Morgan GBI EM Global Diversified USD	-14.92	-5.72	-8.98	16.76	-1.75	15.68	21.98	-5.22	18.11	15.22
Citigroup 90-Day Treasury Bills	0.03	0.03	0.05	0.07	0.08	0.13	0.16	1.80	4.74	4.76